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**BEFORE THE COMMISSIONER OF SECURITIES AND INSURANCE  
OFFICE OF THE STATE AUDITOR  
STATE OF MONTANA**

IN THE MATTER OF THE CONVERSION	)	Case No.: INS-2012-238
OF BLUE CROSS AND BLUE SHIELD OF	)	
MONTANA, INC. AND ALLIANCE WITH	)	
HEALTH CARE SERVICE	)	
CORPORATION,	)	
	)	
	)	
Applicants.	)	
	)	

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**DIRECT TESTIMONY OF**

**MICHAEL E. FRANK  
PRESIDENT AND CHIEF EXECUTIVE OFFICER  
BLUE CROSS AND BLUE SHIELD OF MONTANA, INC.**

**MARCH 5, 2013**

1 **Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.**

2 **A.** My name is Michael E. Frank. I am the President and Chief Executive Officer of Blue  
3 Cross and Blue Shield of Montana, Inc., a Montana nonprofit health service corporation  
4 ("BCBSMT"). My business address at BCBSMT is 560 North Park Avenue, Helena,  
5 Montana, 59601.

6 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

7 **A.** I received a Bachelor's of Science Degree in 1989 from Montana State University. In  
8 1995, I received a Juris Doctorate Degree with high honors from the University of  
9 Montana School of Law and was admitted to the Montana Bar that same year.

10 **Q. PLEASE DESCRIBE YOUR EMPLOYMENT HISTORY.**

11 **A.** After receiving my law degree, I worked for the Crowley, Haughey, Hanson, Toole, and  
12 Dietrich law firm from 1994 to 1999 as an Associate Attorney. In 1999, I was recruited  
13 to join BCBSMT's legal department as an Associate General Counsel. In 2002, I became  
14 a team leader in Operations and was responsible for BCBSMT's self-funded business. In  
15 January 2003, I was appointed Assistant Vice President of Regulatory Compliance, and  
16 in January 2004, I was promoted to Vice President, Compliance and Ethics and  
17 Compliance Officer. I was responsible for the establishment, maintenance and  
18 enforcement of BCBSMT's Compliance and Ethics Program. In January 2005, I became  
19 Vice President, Corporate Integrity and Human Resources, and in September 2006, Chief  
20 Administrative Officer. I was responsible for providing leadership and strategic direction  
21 for the Human Resources, Organizational Development, Internal Audit, Privacy and  
22 Security, Compliance and Ethics, and Medicare Compliance departments. In January  
23 2009, I assumed the role of Chief Legal and Operations Officer. In that capacity, I was  
24 responsible for the legal affairs of the company as well as its internal operations. At that  
25 time, I also was named President of Combined Benefits Management, Inc., BCBSMT's

1 principal holding company and subsidiary. In February 2010, I became President of  
2 BCBSMT and in December of 2010, I was named President and CEO of BCBSMT, the  
3 position I currently hold.

4 **Q. HAVE YOU PREVIOUSLY TESTIFIED IN FORMAL PROCEEDINGS BEFORE**  
5 **AN OFFICER OF THIS STATE OR IN A FORMAL PROCEEDING IN ANY**  
6 **OTHER STATE OR THE FEDERAL GOVERNMENT?**

7 **A.** No.

8 **Q. PLEASE PROVIDE A BRIEF SUMMARY OF YOUR TESTIMONY.**

9 **A.** My testimony will provide facts in support of the approval from the Montana State  
10 Auditor, *ex officio* Commissioner of Insurance (“Commissioner”) and the Montana  
11 Attorney General (“Attorney General”) of the proposed alliance between BCBSMT and  
12 Health Care Service Corporation, a Mutual Legal Reserve Company (“HCSC”).  
13 BCBSMT and HCSC jointly seek approval of the proposed alliance from the  
14 Commissioner and Attorney General, and have filed an Application for Approval of  
15 Alliance (“Application”) pursuant to Montana Code Annotated §§ 35-2-609, 35-2-617  
16 and Title 50, Chapter 4, part 7 (“Conversion Statute”). Pursuant to the terms of the  
17 proposed alliance, HCSC will acquire the insurance and Administrative Services Only  
18 (self-funded) (“ASO”) operations and related assets, and specified associated liabilities of  
19 BCBSMT (“Acquired Business”). My testimony will include: (1) background  
20 information regarding BCBSMT; (2) a discussion of the reasons that BCBSMT needed  
21 an alliance with another Blue health plan; (3) the steps BCBSMT took to identify an  
22 alliance partner; (4) why and how BCBSMT chose to enter into an alliance with HCSC;

1 (5) how the alliance will benefit BCBSMT; BCBSMT's policyholders, providers, and  
2 employees; and the citizens of Montana; and (6) what actions BCBSMT would need to  
3 take to remain competitive and the potential impacts if there is not an alliance with  
4 another Blue plan.

5 **Q. PLEASE PROVIDE SOME HISTORICAL BACKGROUND ABOUT BCBSMT.**

6 **A.** BCBSMT is a nonprofit health service corporation, providing comprehensive health  
7 insurance and third-party administration services throughout Montana. Historically, Blue  
8 Cross (the Hospital Service Association) entered Montana in 1940 and Blue Shield  
9 (Montana Physicians' Service) entered Montana in 1946. In 1986, the two companies  
10 merged to form BCBSMT. As such, in some form, BCBSMT is Montana's oldest and  
11 largest health insurer and has operated in Montana for over 70 years as an independent  
12 licensee of the Blue Cross and Blue Shield Association ("BCBSA").

13 **Q. PLEASE PROVIDE SOME GENERAL BACKGROUND ABOUT BCBSMT'S**  
14 **CURRENT OPERATIONAL STRUCTURE.**

15 **A.** As of December 31, 2012, BCBSMT has approximately 271,152 members. BCBSMT  
16 has a provider network consisting of approximately 2,200 physicians, 60 Montana  
17 hospitals (representing all the hospitals in Montana), and 3,480 allied healthcare  
18 providers. As reported in its statutory statements, in 2011 BCBSMT had \$562M in gross  
19 premium revenue, an underwriting loss of \$5.3M, a net income gain of approximately  
20 \$3.1M, a December 31, 2011 surplus of approximately \$130.8M, and a surplus of  
21 \$114.4M as of June 30, 2012. BCBSMT currently has an A.M. Best rating of B++,

1 which represents a downgrade from the past, and is based on BCBSMT's underwriting  
2 losses as well as other financial factors.

3 **Q. WHAT TYPE OF ENTITY IS BCBSMT?**

4 **A.** BCBSMT is an independent licensee of the BCBSA and is organized as a nonprofit  
5 mutual benefit corporation under Montana's nonprofit corporation code. BCBSMT is  
6 also licensed as a health service corporation under Montana's Health Service Corporation  
7 code.

8 **Q. WHAT TAXES DOES BCBSMT PAY IN THE STATE OF MONTANA?**

9 **A.** BCBSMT pays the Montana Comprehensive Health Association assessment, the genetics  
10 program insurance fees, the Patient-Centered Outcomes Research Institute Fees, property  
11 taxes, and payroll taxes in the State of Montana. Montana levies a tax of 2.75% on net  
12 premiums on all insurance policies. As a health service corporation, BCBSMT is exempt  
13 from payment of premium taxes.

14 **Q. DOES BCBSMT HAVE ANY SUBSIDIARIES OR OTHER RELATED**  
15 **ENTITIES?**

16 **A.** Yes. Combined Benefits Management, Inc. is a subsidiary and holding company of  
17 BCBSMT. CBMI owns three subsidiaries: (1) Insurance Coordinators, Inc. ("ICMI"); (2)  
18 Health-e-Web, Inc. ("HeW"); and (3) Western States Insurance Agency ("WSIA").  
19 ICMI owns a 49% ownership interest in Peak1 and the other 51% ownership interest is  
20 held by Blue Cross of Idaho. WSIA is in the process of winding down. CBMI also owns  
21 a small interest in WPML, LLC and TriWest. However, HeW is the only subsidiary being  
22 transferred to HCSC as part of the proposed alliance. In addition, BCBSMT owns a

1 small interest in Prime Therapeutics and Regional Advantage Services, LLC. BCBSMT  
2 also has two charitable foundations: the BCBS Foundation for Healthy Montanans and  
3 the Caring Foundation of Montana, Inc., both of which are 501(c) organizations and  
4 licensed affiliates of the BCBSA.

5 **Q. YOU MENTION THAT BCBSMT IS A LICENSEE OF BCBSA. CAN YOU**  
6 **PROVIDE US WITH SOME GENERAL BACKGROUND ON THE BCBS**  
7 **SYSTEM?**

8 **A.** The BCBSA is a national association of 38 independent, community-based and locally  
9 operated Blue Cross and Blue Shield ("BCBS" or "Blue") companies. The BCBSA owns  
10 and manages the BCBS trademarks and names in more than 170 countries and territories  
11 around the world. The BCBSA grants licenses pursuant to a license agreement to  
12 independent companies to use the BCBS trademarks and names in exclusive geographic  
13 areas. The BCBS system is the nation's oldest and largest family of health benefits  
14 companies. Historically, in the mid-1970s, there were nearly 130 independently operated  
15 BCBS companies in the BCBS system. As a result of consolidation to compete with the  
16 nationally based, for-profit insurance carriers like Cigna, United Healthcare, Aetna, and  
17 Humana, the number of independently operated BCBS companies had fallen to less than  
18 60 by the end of the 1990s, and to the 38 independently operated BCBS companies today.

19 **Q. HOW MANY MEMBERS DO THE BCBS COMPANIES HAVE?**

20 **A.** Collectively, the 38 BCBS companies provide healthcare coverage for nearly 100 million  
21 people -- one-third of all Americans -- in all 50 states, the District of Columbia and  
22 Puerto Rico.

1    **Q.    WHAT DOES IT MEAN TO BE A LICENSEE OF THE ASSOCIATION?**

2    **A.**    It means that the BCBSA granted BCBSMT an exclusive license to use the Blue Cross  
3           and Blue Shield trademarks and names in the State of Montana, and that no other health  
4           insurer is allowed to use those trademarks and names to actively market or sell health  
5           insurance business in the State of Montana. In addition, the BCBSA has minimum risk  
6           based capital ("RBC") requirements that Blue plans must adhere to, and these minimum  
7           RBC requirements are typically stricter than state statutory RBC requirements.

8    **Q.    CAN A BCBSA LICENSEE FREELY TRANSFER OR SELL ITS LICENSE TO**  
9           **ANOTHER HEALTH INSURER?**

10   **A.**    No. The BCBSA license agreement prohibits the sale or transfer of the BCBSA license  
11           and marks to another insurer without the approval of the BCBSA.

12   **Q.    CAN YOU DESCRIBE THE SCOPE OF THE BCBS COMPANIES' PROVIDER**  
13           **NETWORKS?**

14   **A.**    Nationwide, more than 96% of hospitals and 91% of professional providers contract  
15           directly with the BCBS companies. Furthermore, through the BlueCard program, the 38  
16           independent BCBS licensees offer their members nationwide coverage and access to this  
17           vast network of providers. This network is critical to ensuring the independent Blue  
18           plans can compete with national carriers.

19   **Q.    WHAT IS THE BLUECARD PROGRAM?**

20   **A.**    In its simplest form, the BlueCard program enables members of one BCBS plan to obtain  
21           healthcare services while traveling or living in another BCBS plan's service area.  
22           Through an integrated electronic network for claims processing and reimbursement,

1 BlueCard enables BCBS members to obtain healthcare services while traveling or living  
2 anywhere across the United States. Therefore, the BlueCard program is part of what  
3 enables the 38 BlueCard companies to compete against national carriers and service  
4 members across the country.

5 **Q. WHEN DID BCBSMT BEGIN TO CONSIDER AN ALLIANCE OR OTHER**  
6 **PARTNERSHIP WITH ANOTHER BLUE PLAN?**

7 **A.** During my time at BCBSMT, there have been ongoing conversations about BCBSMT's  
8 ability to remain independent, including periodic discussions with the BCBSMT Board of  
9 Directors ("Board"). When I interviewed for the CEO position in August 2010, I  
10 discussed with the Board my concerns about BCBSMT's ability to operate on its own and  
11 began discussing some sort of shared services or outsourcing arrangements with Blue  
12 plans and other entities. I started visiting with the Board chair in early 2012 about  
13 BCBSMT's ability to remain independent. After ongoing analysis, a small group began  
14 drafting a white paper in March 2012, which formally outlined our options. In May 2012  
15 the white paper was presented to the Executive Committee of the Board, which was  
16 followed by a lengthy discussion of the options and which Blue plans to approach as  
17 potential partners. The Board was seriously considering the possibility outlined in the  
18 white paper of an alliance with another Blue plan because recent years had been  
19 financially challenging for BCBSMT on multiple fronts. As an initial matter, BCBSMT  
20 faced years with a decreasing and shifting membership due to increased competition in  
21 Montana from national for-profit and other multistate carriers and players. At the same  
22 time, BCBSMT had seen an increase in higher dollar claims utilization resulting in



1 increased insurance risk exposure. As a result, and even while BCBSMT has been  
2 continually reducing its administrative costs, primarily through a reduction of employee  
3 positions, BCBSMT has had difficulty realizing an underwriting gain and its RBC has  
4 been declining. BCBSMT similarly does not have access to the capital needed for  
5 investments to expand its capabilities and services in order to meet the current demands  
6 of the business, and importantly, the pressures of the new post-healthcare reform  
7 marketplace.

8 **Q. WHY DID THE BOARD FEEL IT WAS NECESSARY TO SEEK AN ALLIANCE**  
9 **WITH ANOTHER BLUE PLAN?**

10 **A.** As mentioned before, the BCBSMT Board had concerns with the company's financial  
11 position, membership, and increasing technology needs. In addition, the Board  
12 anticipated that the new marketplace would be even more challenging for small  
13 companies like BCBSMT, with new market structures such as public and private  
14 healthcare exchanges competing for membership and ongoing encroachment from large,  
15 national competitors who have ready access to capital and the benefits of large scale to  
16 drive the operational efficiencies and cost containment measures needed to remain price  
17 and market competitive. These factors become even more important in the face of price  
18 and revenue constraints imposed under the Patient Protection and Affordable Care Act  
19 ("ACA"), including such measures as medical loss ratio requirements, potential rate  
20 increase limits, and the elimination of underwriting protections. In light of the increasing  
21 financial pressures and the challenges posed by the new marketplace, the Board  
22 acknowledged that BCBSMT's current business model needed to change. The Board

1 also recognized that its preferred business model was not one of reducing more jobs or  
2 services to its customers. Instead, the Board wanted a model that would ensure that  
3 BCBSMT would continue to thrive as it had for over 70 years, and that it would be here  
4 for the long run to serve Montana in fulfillment of its nonprofit mission of providing  
5 cost-effective, accessible, and quality healthcare plans to all Montanans. Accordingly, the  
6 BCBSMT Board explored and analyzed various business arrangements that would benefit  
7 BCBSMT such as alliances and shared services arrangements, and ultimately decided that  
8 an alliance with another Blue plan would be in the best interest of BCBSMT, its  
9 policyholders, providers, and employees. A shared services arrangement or outsourcing  
10 would have addressed BCBSMT's information technology needs in the short term, but  
11 also likely would have required the elimination of jobs. The Board determined that a  
12 shared services outsourcing arrangement would not, however, address the larger issues a  
13 small insurer such as BCBSMT currently faces and will face after all of the provisions of  
14 ACA take effect in 2014, such as the lack of scale and the ability to better manage and  
15 absorb risk.

16 **Q. WHAT WERE SOME OF THE KEY FACTORS THE BCBSMT BOARD**  
17 **CONSIDERED WHEN CHOOSING A POTENTIAL ALLIANCE PARTNER?**

18 **A.** First and foremost, the partner needed to be a nonprofit, non-investor owned ("NIO")  
19 entity that would continue the use of the BCBS name. Our goal was to continue to  
20 maintain a viable local nonprofit BCBSMT presence, under local management, in  
21 Montana. The Board determined at the beginning of its search that it was of utmost  
22 importance to preserve BCBSMT's interest in serving Montana in the nonprofit BCBS

1 tradition. Therefore, in selecting an alliance partner, BCBSMT was focused on a potential  
2 BCBS ally that would share and preserve the nonprofit commitment of BCBSMT and its  
3 commitment to the Montana community. In addition, due to the heavy competitive and  
4 financial challenges BCBSMT is facing, and will continue to face, it was critical to our  
5 Board and management that we affiliate with an entity that was not only strong  
6 financially, but also had very large scale. This scale would allow delivery of the  
7 operating efficiencies, access to capital, and cost containment initiatives BCBSMT needs  
8 to remain competitive and viable.

9 **Q. WHY WAS IT SO IMPORTANT TO THE BOARD TO PRESERVE BCBSMT'S**  
10 **NONPROFIT TRADITION?**

11 **A.** It is our longstanding philosophical focus on providing access to insurance and care,  
12 rather than maximizing profit for the benefit of investors. BCBSMT's nonprofit tradition  
13 underlies its fundamental mission and values. For over 70 years, BCBSMT has always  
14 worked to be fiscally responsible, but in its choices of how to do so, it has always been  
15 key to ensure its continuation as a strong nonprofit institution – one in which its  
16 communities, policyholders, providers, and employees are core to its purpose.

17 **Q. DID ANY OF THE RULES IN THE BCBSA LICENSE AGREEMENT AFFECT**  
18 **THE COMPANIES YOU CONSIDERED FOR AN ALLIANCE?**

19 **A.** Yes. Only other licensees of BCBSA may hold the licenses of other Blue plans with the  
20 consent of the BCBSA. Therefore, while BCBSMT could have sold its assets and  
21 operations to a non-Blue company, in order to maintain the use of the Cross and the  
22 Shield and use of the name of BCBSMT as a Blue-branded company, it was very

1 important to the Board and management for BCBSMT to try to align with another Blue  
2 plan to, among other things, protect the use of that license.

3 **Q. DID THE BOARD CONSIDER THE REQUIREMENTS OF THE MONTANA**  
4 **CONVERSION STATUTE IN CONSIDERING COMPANIES FOR AN**  
5 **ALLIANCE?**

6 **A.** No. Of course the Board was aware of the statute, but it was not a final decision factor.  
7 We focused on companies compatible with BCBSMT's nonprofit tradition, and which  
8 were also financially strong and capable of providing BCBSMT with immediate and  
9 long-term benefits of scale that we could not realize on our own or by partnership with  
10 smaller companies facing similar challenges.

11 **Q. WHY WERE FINANCIAL STABILITY AND SCALE SO IMPORTANT TO THE**  
12 **BOARD?**

13 **A.** The BCBS plan had to be strong financially, with sufficient capital reserves to invest in  
14 BCBSMT's operational and critical technological upgrades. As I stated, the Blue plan  
15 needed to be large and stable to provide BCBSMT, now and into the future, the critical  
16 benefits of operating and capital scale, the absence of which is creating so many  
17 challenges for small carriers like BCBSMT. This scale was also important to ensure that  
18 the nonprofit mission was preserved. The Board did not want to partner with a plan that  
19 was nonprofit today, but would convert to a for-profit plan in the future because of capital  
20 access needs. The Board was also concerned about choosing an alliance partner that was  
21 smaller and had the likelihood of being consolidated with a larger company because of  
22 the needs for size and scale given the uncertainty in the marketplace at some point in the

1 future. BCBSMT did not want to go through this process twice. Similarly, information  
2 technology is a very important capability in the insurance business and will become even  
3 more important in the future. Reducing and controlling cost are central goals of  
4 healthcare reform, and adopting best practices and new technology systems are seen as a  
5 means of increasing efficiency and lowering costs for health insurers. However, the  
6 significant financial investments required of BCBSMT to acquire or maintain the  
7 information technology systems required in the future was a significant concern given  
8 BCBSMT's current and projected financial strength and lack of scale. So, information  
9 technology as a core competency was a critical criterion for BCBSMT to consider in an  
10 alliance partner. The Board also wanted a partner that could bring resources and skill sets  
11 not available in Montana.

12 **Q. WHAT OTHER FACTORS WERE IMPORTANT TO THE BOARD WITH**  
13 **REGARD TO POTENTIAL PARTNERS?**

14 **A.** In addition to the structural and financial requirements, we wanted the alliance to be an  
15 ongoing success both philosophically and operationally, so we looked at factors that  
16 demonstrated a good fit for the company and Montana. Organizational and cultural fit  
17 was very important to BCBSMT, in that the Board believed there must be compatibility  
18 between BCBSMT and the alliance partner regarding what a BCBS company should be  
19 and how it should operate. The Board believed that healthcare is best delivered locally,  
20 with an emphasis on local management and growth in Montana, but with a meaningful  
21 voice in the larger enterprise. The Board also believed the focus of an alliance partner's  
22 strategy should be on the core business of health insurance and wanted an alliance that

1 was dedicated to that core business. The Board wanted a partner that shared BCBSMT's  
2 commitment to compliance, both internally and externally in its relationships with  
3 regulators and other stakeholders. The Board also wanted a company that had both a  
4 long-term strategy and a short-term operating plan with a strong local presence. The  
5 Board believed that addressing all of these factors would be the best way to protect  
6 current and future policyholders and our employees, and offer the opportunity for future  
7 jobs for Montanans.

8 **Q. WAS THE PURCHASE PRICE AN IMPORTANT CONCERN TO THE BOARD**  
9 **IN TERMS OF ANY POTENTIAL ALLIANCE?**

10 **A.** Certainly. But price did not drive the decision. From the beginning, the Board and  
11 executive team operated under the understanding that the purchase price had to be  
12 determined at fair market value. The Board understood that the value would be  
13 determined by an independent valuation as is required by the Conversion Statute.

14 **Q. PLEASE EXPLAIN HOW YOU BEGAN AND NARROWED THE SELECTION**  
15 **PROCESS?**

16 **A.** BCBSMT executives and board members knew from the beginning that it would only  
17 pursue an alliance with another Blue plan so as to maintain both the use of the Cross and  
18 Shield brands and the long-standing Blue history in Montana. As a member of the  
19 overall Blue system, BCBSMT has a long history with the BCBSA and with the other  
20 limited number of Blue plans in the country. BCBSMT's employees, represented at  
21 many levels throughout the company, and particularly at the executive level, continually  
22 interact with the BCBSA and its colleagues at other Blue plans through meetings, calls,

1 and attendance at BCBSA conferences. For example, I regularly attend the BCBSA CEO  
2 Board meetings, roundtables, Western leadership meetings, other board meetings  
3 involving Blue plans, and other related meetings and conferences. Knowledge and  
4 information about the financial strength, mission, strategic direction, operational  
5 performance, reputation and culture of many of the other Blue plans acquired through  
6 reporting to and continued experience with the BCBSA and with the Blue plans informed  
7 the selection process from the start. Through that knowledge we were then able to  
8 eliminate a number of plans that did not meet the Board criteria previously described.  
9 First, we began by eliminating all of the for-profit Blue plans due to the Board's direction  
10 and requirement that BCBSMT not move to a for-profit plan. We further narrowed the  
11 list by eliminating those with insufficient size and those not in our general geographic  
12 location, which removed all single-state plans and some of the multistate Blue plans.  
13 This analysis narrowed our list of potential partners to two multistate NIO Blue plans. In  
14 April 2012, the Board chair and I had our first formal meeting with the CEO of one of the  
15 multistate Blue plans we ultimately considered. At that meeting, he indicated an interest  
16 in exploring a partnership with BCBSMT. In May, the Board chair and I made contact  
17 with the second Blue plan to fully explore our options. This call was to HCSC President  
18 and CEO, Pat Hemmingway Hall. During that call, she stated her interest in continuing  
19 discussions regarding a possible partnership. At the end of May, the Board chair,  
20 BCBSMT CFO Mark Burzynski, and I traveled to Chicago to do an on-site visit with  
21 executives at HCSC and learn more about HCSC.  
22 After that, I, along with select members of our executive team, continued research and

1 discussions with our top two choices regarding their companies and interest in a  
2 relationship with BCBSMT.

3 **Q. WHAT DID THE BOARD DO NEXT?**

4 **A.** In late May or early June 2012, the Board invited the President and CEO of HCSC and  
5 the President and CEO of the other nonprofit Blue plan (along with their respective  
6 executive staff) to meet separately with the Board at a non-BCBSMT facility in Three  
7 Forks, Montana. On June 11, 2012, the Board, staff members, and counsel met with the  
8 HCSC President and CEO, Pat Hemmingway Hall, along with her executive staff and a  
9 board member, for a one-day meeting. On June 12, 2012, the BCBSMT Board, staff  
10 members, and counsel met with the other nonprofit Blue plan President and CEO, his  
11 executive staff, and a board member for a one-day meeting. Each plan presented a plan  
12 history, a description of the current operations, a description of subsidiary functions, the  
13 future strategic direction of its multistate plan in light of healthcare reform (or ACA), the  
14 changing marketplace, and increased national competition. BCBSMT's staff members  
15 explained BCBSMT's strategic direction and current marketplace demands and  
16 challenges. The Board and each plan discussed partnership opportunities.

17 **Q. AFTER THE CONCLUSION OF THE PRESENTATIONS, WHAT DID THE**  
18 **BOARD DO NEXT?**

19 **A.** After these two days of meetings, the Board discussed each of the potential plans and  
20 assessed them against the evaluative factors described above. The Board did not make a  
21 final decision at that point even though both plans met our threshold requirements and are  
22 healthy, successful, and competitive entities. After additional careful consideration and



1 multiple follow-up conversations with the Board and the two plans, the Board decided to  
2 limit further discussions on a potential relationship and undergo more due diligence with  
3 HCSC. The Board concluded that HCSC best fit BCBSMT's needs for the following  
4 reasons: (1) HCSC is a mutual legal reserve company, doing business as a nonprofit  
5 healthcare service plan; (2) HCSC currently operates the BCBS plans in Illinois, New  
6 Mexico, Oklahoma, and Texas, providing comprehensive health insurance products and  
7 services to over 13 million members in those states; (3) HCSC is the country's largest  
8 NIO health insurer, the fourth largest health insurer overall, and currently one of the  
9 strongest Blue plans in the nation; (4) HCSC has a proven track record in successfully  
10 bringing together operations in other states, and incorporating them into existing HCSC  
11 operations, while maintaining local executive leadership, an emphasis on a strong local  
12 presence and ongoing focus on the benefit of its members; (5) the HCSC model met the  
13 criterion of maintaining a local voice and presence; (6) HCSC owned its own proprietary  
14 technology software which had impressive functionality; and (7) HSCS had the requisite  
15 financial strength to help BCBSMT absorb risk.

16 **Q. DID BCBSMT CONDUCT FURTHER DUE DILIGENCE?**

17 **A.** Yes. BCBSMT designated two internal due diligence teams to conduct due diligence: a  
18 transaction due diligence team led by Mark Burzynski, the Chief Financial Officer, and  
19 an operational due diligence team led by Mary Belcher, BCBSMT General Counsel.

20 **Q. WHEN AND HOW WAS DUE DILIGENCE CONDUCTED?**

21 **A.** The teams commenced due diligence in June 2012 and completed due diligence in  
22 October 2012. HCSC was also conducting due diligence of BCBSMT during this period.

1 BCBSMT conducted due diligence through multiple in-person visits with HCSC in  
2 Chicago, Helena, Minneapolis, and North Dakota, as well as frequent teleconferences.  
3 The two due diligence teams also did extensive research on areas such as the HCSC's  
4 financial strength, as well as its technology, claims system, customer service, operations,  
5 and corporate culture. In addition to these two due diligence teams, Linda Ganno,  
6 BCBSMT's then Chief Operating Officer, Deb Thompson, BCBSMT Compliance  
7 Officer and Senior Director Corporate Affairs and Human Resources, Mark Burzynski,  
8 BCBSMT Chief Financial Officer, and I made an on-site visit to the HCSC Oklahoma  
9 division to personally observe the organizational culture and other areas of the plan.

10 **Q. WHAT WERE THE RESPONSIBILITIES OF THE TRANSACTION DUE**  
11 **DILIGENCE TEAM?**

12 **A.** The transaction team conducted due diligence, in part, to substantiate HCSC's  
13 commitment to the nonprofit business model and a culture that emphasized the  
14 importance of being local. Further, the team's role was to ensure that HCSC offered the  
15 requisite financial strength, size and scale, employment growth opportunities, and  
16 technology and capabilities to enable BCBSMT to serve the residents of Montana, as a  
17 nonprofit entity, now and into the future.

18 **Q. WHAT DID THE TRANSACTION TEAM CONCLUDE?**

19 **A.** The team confirmed that HCSC offered the best fit as a transaction partner due to the  
20 following reasons: (1) HCSC is organized as a mutual health insurance company formed  
21 for the purpose of operating a nonprofit health service plan, has done so for over 75  
22 years and is strategically and operationally committed to remaining one; (2) HCSC

1 remains committed to its fundamental health insurance business at a time when many  
2 health insurers are diversifying; (3) HCSC's financial strength: HCSC has the highest  
3 reserves of any NIO Blue plan with over \$9.4 billion in statutory surplus at the end of the  
4 first quarter in 2012, and at the end of 2011, HCSC had an RBC ratio of 1,227% which  
5 assured the Board that HCSC had the requisite reserves to ensure ongoing payment of  
6 claims for all of its Blue plans including those of BCBSMT if the transaction is approved,  
7 while at the same time providing the funding and capital access necessary to make  
8 competitive operational and infrastructure investments now and into a challenging future  
9 marketplace; (4) HCSC's operates BCBS plans in Illinois, Texas, Oklahoma, and New  
10 Mexico; each has a local affiliate board and a distinct regional and community presence;  
11 (5) HCSC has over 13 million members, maximizing an ability to spread risk; (6) HCSC  
12 is a growing company, and has grown its workforce by 20% in the last six years,  
13 including growth at the local level; (7) HCSC successfully integrated the BCBS plans in  
14 Texas in 1999, New Mexico in 2001, and Oklahoma in 2005 for the benefit of its owner-  
15 members; and (8) HCSC's technological capabilities are competitive with, and in many  
16 cases, superior to major national carriers.

17 **Q. WHAT WERE THE RESPONSIBILITIES OF THE OPERATIONAL DUE**  
18 **DILIGENCE TEAM?**

19 **A.** The operational team conducted due diligence to provide an overview of HCSC's  
20 operational and service areas from an informational perspective, contrasting, where  
21 possible, the expansion of services for BCBSMT members. The team specifically  
22 reviewed the following areas: information technology; privacy and security; operations;

1 medical and behavioral care management; analytics and information management; sales  
2 and marketing; healthcare services; compliance and human resources; and corporate  
3 culture. The team also reviewed HCSC's financial, legal, and internal audit areas.

4 **Q. WHAT DID THE OPERATIONAL TEAM CONCLUDE?**

5 **A.** The team concluded that HCSC presented many expanded services and benefits to  
6 BCBSMT's applicants, policyholders, groups, providers, producers, and employees in the  
7 various operational and service areas reviewed. To name just a few, HCSC's proprietary  
8 Blue Chip system is a state-of-the-art, real-time claims processing system. Blue Chip is a  
9 highly reliable and stable system and will immediately increase BCBSMT's efficiency in  
10 administering its core health insurance business without the need to rely upon an external  
11 vendor for these services. HCSC offers groundbreaking Concierge Service Analytics  
12 technology, an innovative customer service initiative that involves language-based  
13 analytics software to record and interpret policyholder calls. This will significantly  
14 enhance BCBSMT's policyholder-customer service interactions and  
15 communications. HCSC's enterprise data warehouse is also outstanding and provides  
16 state of the art databases and reporting systems for use in determining the overall quality  
17 of provider care, reimbursement, and customer reporting. These data warehouse  
18 capabilities will immediately enhance BCBSMT's competitiveness in the marketplace  
19 financially and will enable BCBSMT to meet its customers' needs more effectively.  
20 HCSC's two state-of-the-art Tier 4 data centers in Waukegan, Illinois and Fort Worth,  
21 Texas will expand and enhance the security and reliability of our policyholders' protected  
22 health information and other sensitive information. HCSC has been continually

1 recognized for the past decade as having one of the best corporate compliance programs  
2 in the United States, having won 11 consecutive Compliance Best Practice awards from  
3 the Health Ethics Trust. The team was also impressed and moved by HCSC's innovative  
4 benefit programs. One that stood out was the "Seasons of Life" program which assists  
5 survivors after the death of a family member in managing financial and healthcare-related  
6 paperwork to simplify remaining healthcare claims, answering questions and letting  
7 members know that HCSC is available to assist them. HCSC's wholly owned subsidiary,  
8 Hallmark, will provide BCBSMT with a robust, state-of-the-art portal that will allow  
9 individuals to obtain a quote directly on their own initiative or engage a producer to assist  
10 in obtaining a quote. This system also has a very robust Client Management System for  
11 the use of our producers and brokers. HCSC has already implemented mobile technology  
12 for its applicants and policyholders, allowing them to use their mobile phone to log in to  
13 HCSC's web site to shop for insurance or secure member sites to check their claim status,  
14 order policyholder identification cards, or find a provider or hospital. This proven  
15 technology will also be made available to BCBSMT's applicants and policyholders.  
16 These are just a few of the many expanded services and benefits to which BCBSMT and  
17 its applicants, policyholders, groups, providers, producers, and employees will have  
18 access.

19 **Q. DID THE TEAM IDENTIFY ANY OTHER HCSC OPERATIONAL AREAS**  
20 **THAT IT BELIEVED WOULD BE BENEFICIAL TO BCBSMT?**

21 **A.** Yes. The team also looked at HCSC's legal, financial and internal audit areas, and  
22 concluded that the additional staff and resources offered by HCSC, particularly in the

1 areas of legal, compliance, and internal audit, will enable BCBSMT to review, analyze,  
2 react to, and implement more quickly new laws and regulations, particularly on the  
3 federal level, including employee communication and training. By freeing up plan  
4 resources at the local level, compliance, legal, and internal audit will be able to focus on  
5 state-specific laws and regulations and do more state-specific risk assessments,  
6 proactively planning for and more quickly implementing improvements and changes.

7 **Q. WHAT WERE THE RESULTS OF YOUR ONSITE VISIT TO THE OKLAHOMA**  
8 **PLAN?**

9 **A.** The then Chief Operating Officer, the Compliance Officer, the Chief Financial Officer,  
10 and I were immediately impressed with the Oklahoma building. The building was new  
11 and clearly a source of pride for the plan employees. It was evident that the plan did  
12 business as Blue Cross Blue Shield of Oklahoma and was overseen by Oklahoma  
13 leadership. The flavor of the plan was enhanced with local employee photos, work by  
14 local artists, and the Oklahoma Blue Cross Blue Shield brand. In conversations with  
15 local leadership and employees, it was clear that everyone believed the affiliation with  
16 HCSC, which they referred to as “the enterprise,” had enhanced their ability to do  
17 business. Employees voiced relief from implementation of complex and costly  
18 information technology and regulatory projects and gratitude for access to additional  
19 resources in acknowledging the enterprise as a valued resource. In addition, we toured  
20 one of the full service units and visited with staff. Employees were eager to discuss their  
21 work and clearly proud of the unit and their performance. We were able to observe  
22 customer advocates answering live calls and witness firsthand the ease with which they

1 navigated through the BlueChip system. For example, if one call center is barraged with  
2 calls, the system can be rerouted so that another call center can take the call overflow. In  
3 this way, the other call center is provided immediate relief, so that customer calls are  
4 handled and answered on a timely basis.

5 **Q. DID THE DUE DILIGENCE TEAM CONCLUDE THE PROPOSED ALLIANCE**  
6 **WITH HCSC MET THE GOALS OF AFFILIATION AS ESTABLISHED BY THE**  
7 **BOARD?**

8 **A.** Yes. In addition to its dedication to the nonprofit model, HCSC has a proven track record  
9 in successfully bringing Blue plans together and a demonstrated commitment to  
10 providing coverage to as many people as possible. HCSC's business model emphasizes  
11 maintaining a local presence, managed by local executive leadership. HCSC provides  
12 financial strength, efficiencies of size and scale, and strong technology capabilities.  
13 HCSC will retain BCBSMT's employees as of the date of closing. HCSC is committed  
14 to providing employment growth opportunities, as evidenced by its interest in adding  
15 approximately 100 new jobs in Great Falls, Montana. Importantly, HCSC's and  
16 BCBSMT's corporate cultures were determined to be strikingly similar in their respective  
17 commitments to conducting business ethically and to making a lasting and meaningful  
18 difference in the communities they serve.

19 **Q. DID SENIOR MANAGEMENT SHARE THE RESULTS OF THE DUE**  
20 **DILIGENCE REVIEW WITH THE BOARD?**

21 **A.** Yes. We shared our due diligence conclusions in two separate documents that were  
22 presented to the Board: (1) the Transaction Summary and Analysis on October 8, 2012,

1 and (2) the Operational Due Diligence Report on October 22, 2012.

2 **Q. WHAT ACTION DID THE BCBSMT BOARD TAKE WITH RESPECT TO**  
3 **SENIOR MANAGEMENT'S PRESENTATION AND RECOMMENDATION?**

4 **A.** At a meeting held on November 7, 2012, the BCBSMT Board met and approved by  
5 resolution the proposed alliance with HCSC. More specifically, the BCBSMT Board  
6 directed senior management to take the necessary steps to form the alliance, including  
7 authorizing senior management to execute the APA on terms generally consistent with  
8 senior management's presentations.

9 **Q. DID YOU ATTEND THE NOVEMBER 7, 2012, BCBSMT BOARD MEETING?**

10 **A.** Yes.

11 **Q. DID THE BOARD IDENTIFY OR RAISE ANY CONCERNS OR RISKS**  
12 **RELATED TO THE DUE DILIGENCE FINDINGS OR OTHERWISE WITH**  
13 **RESPECT TO AN ALLIANCE WITH HCSC?**

14 **A.** The Board did not identify or raise any concerns or risks with respect to the due diligence  
15 findings. Just as would be the case with any potential partner, the Board did want to  
16 ensure that: (1) employees would have continued employment and retirement protection;  
17 (2) that BCBSMT would maintain its local presence; (3) that the company would  
18 continue under the name BCBSMT; and (4) that the local organization would continue to  
19 have a voice in the larger enterprise and would remain the frontline face to the  
20 marketplace and to providers. Although the Board knew it had responsibility with  
21 respect to the valuation of BCBSMT, the Board was also aware that the valuation of  
22 BCBSMT would be addressed through an independent valuation as required by Montana



1 law.

2 **Q. HOW INVOLVED WAS THE BCBSMT BOARD IN THIS TRANSACTION?**

3 **A.** The BCBSMT Board was instrumental in identifying the need and search for an alliance  
4 partner, and has overseen, participated in, and remained actively involved throughout the  
5 entire process. The Board was continually informed by management of every major  
6 component of the transaction, and the transaction was on every board agenda and almost  
7 every committee agenda after May 2012. We used frequent teleconferences to ensure  
8 continued communication with all Board members. The Board was fully engaged  
9 throughout the entire process.

10 **Q. WHEN DID BCBSMT BEGIN NEGOTIATING THE TERMS OF THE**  
11 **ALLIANCE WITH HCSC?**

12 **A.** BCBSMT and HCSC began discussions, pending further due diligence by both parties,  
13 on what the possible terms of an alliance might be on or around August 2012. BCBSMT  
14 and HCSC began working on formulating the terms of an Asset Purchase Agreement  
15 (“APA”) as a means of trying to identify areas of agreement and disagreement while due  
16 diligence was underway.

17 **Q. WAS A FINAL AGREEMENT REACHED?**

18 **A.** Yes. On November 14, 2012, HCSC and BCBSMT entered into the APA that describes  
19 the transaction for which we are seeking approval in this proceeding, after the purchase  
20 price was determined based on an independent, third-party valuation as required by the  
21 Montana Conversion Statute, and as I discussed earlier. The APA is attached as Exhibit  
22 3 to the Application.

1     **Q.     HOW WAS THE PURCHASE PRICE DETERMINED?**

2     **A.**     As I mentioned, BCBSMT and HCSC throughout the ongoing due diligence negotiated  
3             and came to an agreement with respect to most of the terms of the APA. The only key  
4             term that was not negotiated was the purchase price. With respect to the purchase price,  
5             the parties agreed to obtain an independent, third party valuation of the fair market value  
6             of BCBSMT, as specified in the Montana Conversion Statute. Actuarial and Financial  
7             Modeling, Inc. performed an independent actuarial valuation of BCBSMT's core health  
8             insurance business on behalf of BCBSMT. This valuation was then incorporated into an  
9             overall independent valuation of the fair market value of the total surplus of BCBSMT,  
10            which was performed by Moss Adams LLP.

11    **Q.     FROM THOSE INDEPENDENT VALUATIONS WHAT AMOUNT WAS**  
12       **DETERMINED TO BE THE PURCHASE PRICE FOR THE ASSETS TO BE**  
13       **ACQUIRED BY HCSC?**

14    **A.**     The purchase price was determined to be \$17.6 million for the Acquired Business. It is  
15             important that, if the transaction is approved and closes, BCBSMT management  
16             estimates that approximately \$120 million in assets (including the purchase price) will be  
17             left in old BCBSMT to be distributed to a foundation in accordance with Montana law.

18    **Q.     WHAT DOES THE APA PROVIDE REGARDING BCBSMT'S EMPLOYEES?**

19    **A.**     Stability of the BCBSMT workforce after closing is important to both BCBSMT and  
20             HCSC. Effective as of closing, HCSC will make offers of employment to all employees  
21             listed on BCBSMT's employee roster as of the closing date. There will be no gap in  
22             employment for active employees during the transition. With respect to each employee,

1 HCSC will offer employment at an annual base salary equal to or greater than the annual  
2 base salary of the employee in effect as of immediately prior to the closing.

3 **Q. WILL ANY EMPLOYEES BE REQUIRED TO MOVE TO ANOTHER**  
4 **LOCATION TO RETAIN EMPLOYMENT?**

5 **A.** No, our employees will not be required to move to retain employment. They may have  
6 opportunities to move if they choose to seek employment with the larger enterprise,  
7 however.

8 **Q. WHAT TYPE OF BENEFITS WILL EMPLOYEES HAVE AT HCSC?**

9 **A.** BCBSMT employees will transition to HCSC's benefit programs and will be treated the  
10 same as similarly situated HCSC employees. BCBSMT employees may experience  
11 slight changes in their benefits as a result of the transition, but overall the benefit  
12 offerings at HCSC are comparable and, in some cases, better than what BCBSMT  
13 employees have now. Importantly, an employee's original date of hire with BCBSMT  
14 (and not with HCSC) will be recognized for purposes of determining benefit eligibility  
15 and accruals. This means that Montana employees will come over with their same  
16 seniority and will not be starting over as new hires.

17 **Q. DOES BCBSMT CURRENTLY HAVE A PENSION PLAN FOR ITS**  
18 **EMPLOYEES?**

19 **A.** Yes. BCBSMT has two different pension plans. A pension plan's applicability to an  
20 employee depends on the employee's date of hire and thereafter the employee's  
21 continuous employment. BCBSMT employees employed on December 31, 2004, and  
22 who have remained continuously employed since that date, participate in the Defined

1 Benefit (DB) Plan. BCBSMT employees hired or rehired on or after January 1, 2005,  
2 participate in the Annual Retirement Contribution (ARC) and 401(k) program. BCBSMT  
3 employees participating in the DB Plan also may participate in the 401(k) program.

4 **Q. WHAT HAPPENS TO EMPLOYEES PARTICIPATING IN EITHER PENSION**  
5 **PLAN AS OF THE DATE OF CLOSING?**

6 **A.** With respect to the ARC plan and 401(k) plan, after closing on December 31, 2014, as  
7 may be applicable under the APA, all employees participating in the ARC and 401(k)  
8 plan will accrue no further benefit or compensation under the ARC plan and 401(k) plan.  
9 However, these employees will be eligible to participate in HCSC's cash balance plan  
10 and a 401(k) plan. The combination of these two plans allows participants the  
11 opportunity to accumulate 12 ½ percent or more of pay each year for retirement. The  
12 combined benefit of these plans ranks well within peer industry group benefit plan  
13 offering benchmarks and are in addition to health benefits, paid time off, short term and  
14 long term disability, and other standard employee benefit programs.

15 **Q. WHAT ABOUT EMPLOYEES PARTICIPATING IN THE DEFINED BENEFIT**  
16 **PLAN?**

17 **A.** After review and approval by the BCBSMT Board, BCBSMT decided to use a three-  
18 tiered transition approach to provide post-closing benefit accruals to DB plan participants  
19 based on age and years of vesting services, as the term is defined under the BCBSMT  
20 Pension Plan. An employee in Tier 1 is defined as any employee who currently  
21 participates in BCBSMT's DB plan whose combined age and service equals 75 or who  
22 has 25 years of service. A Tier 1 employee will remain fully grandfathered on the DB

1 plan and will continue to accrue full benefits in the plan. A Tier 1 employee will not be  
2 eligible to participate in HCSC's cash balance plan, but will be eligible to participate in  
3 HCSC's 401(k) plan. An employee in Tier 2 is defined as any employee who currently  
4 participates in BCBSMT's DB plan whose combined age and service equals 60. The DB  
5 plan will be closed to employees in Tier 2 for purposes of further accruals in the plan.  
6 However, the employee's benefits in the DB plan will continue to increase with the  
7 growth in the employee's wages, but will not continue to grow based upon age and  
8 service. Tier 2 employees will be eligible to participate in HCSC's cash balance plan and  
9 401(k) plan. An employee in Tier 3 is defined as any employee who currently  
10 participates in BCBSMT's DB plan and who does not meet the combined age and service  
11 requirements for participating in Tier 1 or Tier 2. The DB plan will be closed to  
12 employees in Tier 3 for purposes of further accruals in the plan and all employees in Tier  
13 3 will stop earning benefits. Tier 3 employees will be eligible to participate in HCSC's  
14 cash balance plan and 401(k) plan. It is important to note that employees will not lose  
15 what they have earned in their respective DB plans.

16 **Q. WILL BCBSMT BE REPRESENTED ON THE HCSC BOARD OF DIRECTORS?**

17 **A.** Yes. One current BCBSMT Board member will be selected to sit on HCSC's Board of  
18 Directors following the closing of the transaction. Most of the other remaining current  
19 directors of BCBSMT will be on the Montana affiliate board that will advise HCSC on  
20 local matters.

21 **Q. WHAT WILL HAPPEN TO BCBSMT'S POLICYHOLDERS ONCE THE**  
22 **TRANSACTION IS COMPLETED?**

1     **A.**     On and after close of the transaction, all former BCBSMT policyholders will become  
2             HCSC policyholders without any break in benefits, coverage, and services. BCBSMT  
3             will remain as it is today and will continue its business as currently conducted. After  
4             close of the transaction, HCSC will continue the business of BCBSMT in Montana and  
5             will use the BCBS marks. The transfer of the BCBS marks to HCSC is pending approval  
6             by the BCBSA. HCSC will do business in Montana under the name “Blue Cross and  
7             Blue Shield of Montana, a division of Health Care Service Corporation, a Mutual Legal  
8             Reserve Company,” and will continue to be regulated by the Montana Commissioner of  
9             Insurance under Montana law.

10    **Q.**     **WHAT WILL HAPPEN TO THE OLD BCBSMT NONPROFIT CORPORATION**  
11             **IF THE TRANSACITON IS APPROVED AND CLOSES?**

12    **A.**     After the close of the transaction, the old corporate BCBSMT entity will retain the  
13             excluded assets and continue to exist after the closing of the transaction to pay or  
14             otherwise discharge the excluded liabilities, but without any ongoing healthcare business,  
15             and will change its name to delete references to “Blue Cross” and “Blue Shield.” Once  
16             the old BCBSMT corporate entity has paid its outstanding liabilities and obligations, it  
17             will voluntarily dissolve and, in doing so, will adopt a voluntary plan of dissolution. The  
18             voluntary plan of dissolution will provide that any remaining funds and assets in its  
19             possession will be distributed to a foundation designated as the recipient of those  
20             proceeds (including the purchase price paid to BCBSMT by HCSC for the Acquired  
21             Business under the APA), as set forth on page 3 of the Application.

22    **Q.**     **WHO WILL OVERSEE THE OLD BCBSMT CORPORATE ENTITY IF THE**

**TRANSACTION IS APPROVED AND CLOSES?**

**A.** BCBSMT suggests that the current Board of BCBSMT appoint a subset of the Board or outside individuals with experience in the industry to oversee the wind down of the old BCBSMT corporate entity if the transaction is approved and after closing.

**Q. WILL THE REMAINING CORPORATE BCBSMT ENTITY HAVE ANY EMPLOYEES?**

**A.** The old BCBSMT corporate entity may elect to hire a few employees or contract with individuals as independent contractors to help with the wind down.

**Q. WHAT OTHER ASPECTS OF THE PROPOSED TRANSACTION DO YOU BELIEVE SUPPORT ITS APPROVAL?**

**A.** As I mentioned, the BCBSMT Board identified a number of factors that are designed to make this transaction successful over the long term. In addition to the decisional criteria I discussed, the transaction will provide many benefits that positively impact Montana stakeholders. For example, HCSC will offer employment for BCBSMT's employees, Montana will have representation on the parent HCSC Board, HCSC will have a Montana affiliate board, the plan will maintain local executive leadership, and there will be a continued commitment to the Montana community. There will also be renewed viability, from financial to technological infrastructure improvements to exchange readiness, which will position BCBSMT to compete in a highly competitive marketplace. The transaction may also present Montana with new job opportunities. On January 8, 2013, HCSC announced that it is currently in the process of exploring the possibility of a new customer service center in Montana. HCSC has considered a number of locations in

1 Montana, but current analysis is focused on Great Falls. While no final decision has been  
2 made, it is possible that a new call center could add approximately 100 new jobs in  
3 Montana. It is important to note these would be new jobs and not a transfer of existing  
4 work from Helena.

5 **Q. DO YOU THINK MONTANA MANAGEMENT WILL HAVE A VOICE IN**  
6 **HCSC'S APPROACH TO ITS BUSINESS?**

7 **A.** Yes. The senior officer in Montana, like the senior officers in Texas, Illinois, and New  
8 Mexico, will sit on the senior management team of HCSC and contribute toward  
9 corporate decisions, including major company decisions. I will become the Plan  
10 President of BCBSMT, HCSC's Montana Division. I will also be relied upon by HCSC  
11 to bring the local perspective, and that perspective will influence HCSC's decision-  
12 making as it affects the local company. My local team and I will interact with Montana  
13 regulators, providers, and member groups.

14 **Q. WILL HCSC BE ACTIVE IN THE LOCAL COMMUNITY?**

15 **A.** Yes. HCSC and all of its Blue plans have a demonstrated presence in, and commitment  
16 to, the communities in which they operate. I believe HCSC will continue BCBSMT'S  
17 commitment to the community, donate to charitable organizations and special needs in  
18 the community, and be a good corporate citizen from the standpoint of community  
19 involvement. For example, in 2011, HCSC provided more than 145,000 immunizations  
20 and 43,000 health screenings to children at risk, volunteered a record 31,224 hours to  
21 support hundreds of local organizations, created safe places to play for 23,000 kids, and  
22 educated nearly 25,000 students about the importance of nutrition to healthy growth.



1 HCSC leadership is personally involved in many civic activities and leadership positions  
2 in community organizations and encourages and incentivizes a culture of community  
3 service amongst their employees.

4 **Q. WHAT IS THE BASIS FOR BCBSMT'S CONFIDENCE THAT HCSC WILL**  
5 **MEET BCBSMT'S EXPECTATIONS?**

6 **A.** First, for many of these matters, HCSC is contractually obligated to perform them. As to  
7 others, HCSC's history related to its respective transactions in Texas, Oklahoma, and  
8 New Mexico was very influential in our decision. HCSC believes in maintaining strong  
9 and viable local health plans. The local divisions are thriving: (1) HCSC either built new  
10 or renovated existing buildings for the employees in each state; (2) HCSC maintains a  
11 strong local presence in each state, managed by local executive leadership; and (3) the  
12 larger HCSC enterprise provides the necessary infrastructure services, upgraded  
13 technology, access to specialized resources and services, all of which enable the local  
14 plans to meet and exceed the marketplace demands of their customers.

15 **Q. DO YOU THINK THE ALLIANCE WITH HCSC WILL ENABLE BCBSMT TO**  
16 **COMPETE MORE EFFECTIVELY IN AND ADD VALUE TO THE MONTANA**  
17 **MARKETPLACE?**

18 **A.** Absolutely. As previously discussed, economies of scale are critical to the ongoing  
19 success of health insurance carriers, particularly as we enter an even more challenging  
20 marketplace. Plans that cannot realize these efficiencies are at a significant competitive  
21 and viability disadvantage. The larger for-profit insurance competitors have lower  
22 administrative costs per policy, far larger membership pools over which to spread risk,

1 and significantly higher reserves and ready access to capital markets. Large for-profit  
2 insurers continue to expand their geographic reach into Montana in an attempt to drive  
3 growth and stock price gains. For example, in the last five years, Cigna has increased its  
4 fully insured group presence over the past five years through its wholly owned  
5 subsidiary, Allegiance Life & Health Insurance Company. Cigna is one of the nation's  
6 largest multistate, for-profit health insurers. Economies of scale, innovative technology,  
7 and strong financial resources have made Cigna and other similar insurers formidable  
8 competitors for small, single-state plans like BCBSMT. BCBSMT's alliance with a large  
9 and stable company like HCSC will help it compete with large for-profit insurers by  
10 accomplishing two goals while still maintaining its NIO status. First, HCSC offers  
11 increased scale for BCBSMT, allowing the consolidated entity to price more  
12 competitively, maintain premiums at a lower level than they otherwise would be, control  
13 costs, employ superior data analytics, and provide more focus on wellness. Second, the  
14 alliance will enable BCBSMT to leverage the core competencies and track record of  
15 innovation of HCSC and its subsidiaries to better serve Montana for another 70 years.

16 **Q. WILL THE ALLIANCE BETWEEN BCBSMT AND HCSC BENEFIT BCBSMT**  
17 **AND ITS POLICYHOLDERS, PROVIDERS, EMPLOYEES, AND THE**  
18 **CITIZENS OF MONTANA?**

19 **A.** Yes. I previously identified a wide range of specific benefits from the transaction for  
20 BCBSMT, its policyholders and employees. We expect similar positive impact on other  
21 Montana stakeholders, including its citizens and providers. As to Montanans generally,  
22 the alliance will allow BCBSMT to make health insurance more accessible to them by

1 controlling administrative costs, making BCBSMT more financially stable, and having  
2 the financial resources to strongly price its fully-insured, risk-based business. The  
3 transaction will also allow BCBSMT to deliver even better quality service to Montana  
4 members. With regard to providers, BCBSMT currently contracts with all of the  
5 providers in Montana who are used to doing business in the Blues system. We fully  
6 anticipate that those providers will remain in the Blues network with HCSC after the  
7 transaction, and will also benefit from the infrastructure HCSC has in place to support its  
8 network of providers, such as quicker reimbursement because of HCSC's ability to  
9 process claims faster and more accurately. We will continue to work with our provider  
10 partners on innovative ways to address the rising costs of healthcare, such as patient  
11 centered medical homes and accountable care organizations.

12 **Q. WHAT WOULD BCBSMT NEED TO DO TO REMAIN COMPETITIVE IF**  
13 **THERE WERE NO ALLIANCE WITH ANOTHER HEALTH PLAN?**

14 **A.** As I have testified, BCBSMT has been facing financial and technology challenges that  
15 we anticipate will only increase with the implementation of healthcare reform and  
16 increasing forms and strength of competition. BCBSMT expects that in the future,  
17 Montana will see new companies entering or redesigned existing companies vying for  
18 market share in all segments of the health insurance and administrative service  
19 marketplace. This is especially true in light of the upcoming insurance exchanges that  
20 begin enrollment in October of this year and become effective January 1, 2014. To  
21 remain competitive, BCBSMT must increase scale and reduce administrative expenses as  
22 a percentage of revenues. Excluding non-income tax items (real estate, state, local,

1 premium, payroll, and other non-income taxes) and regulatory authority fees, BCBSMT's  
2 statutory administrative expense ratio has continually decreased from 2007 – 2011  
3 through reduction in its employee base, consolidation of offices and limiting the number  
4 of technology and tool upgrades. Despite this improvement, BCBSMT still trails HCSC  
5 by approximately 3.5% - 4% in its administrative expense ratio. This difference is  
6 significant. For example, with \$500M in revenues, this differential translates to \$15-  
7 \$20M in lost capital potentially available for needed investment in: (1) product and  
8 service enhancements; (2) declining reserves; and (3) quality measures within the  
9 provider base, equating to lost opportunities to provide better premium rates for current  
10 products. The future market landscape and regulatory environment mandate that  
11 BCBSMT invest in improvements in technology, processes, and services, e.g., the  
12 exchange. This currently can only be achieved through available margins or surplus.  
13 Constraints on current margin capacity and the necessary lead time for implementations  
14 will ultimately force the choice to be through the use of available surplus. Significant use  
15 of surplus for future investment coupled with any growth in business will negatively  
16 impact the statutory RBC metric. A lowering of the statutory RBC metric will potentially  
17 bring several new risks to the forefront. BCBSMT will require resource options to  
18 address the challenges (potentially, even multiple issues simultaneously) swiftly and  
19 efficiently while doing so in a compliant manner. If the alliance is not approved and to  
20 achieve economies of scale, eliminate potential unaffordable investment in technology  
21 and systems, and access key subject matter experts, BCBSMT would continue to  
22 outsource services to meet the coming challenges of the market. Outsourcing would

1 likely result in the loss of locally based jobs to avoid duplication of positions and drive  
2 down administrative costs. BCBSMT would need to reexamine its benefit offerings,  
3 likely leading to current employees leaving the company for other job opportunities.  
4 BCBSMT would also be forced to reevaluate low margin product lines and ultimately  
5 decide on what customer base and market segments it can effectively and efficiently  
6 remain in. It is important to mention that BCBSMT had already begun the process of  
7 outsourcing functions prior to the proposed alliance. As I mentioned earlier, outsourcing  
8 does not address BCBSMT's other key challenges, which include the ability to better  
9 manage and absorb risk due to its size, human resources with the necessary expertise, and  
10 the ability to bring innovative solutions to Montana consumers and providers. Other  
11 areas of potential outsourcing or staff augmentation if the proposed transaction does not  
12 close include: accounting/finance, medical management, legal, actuarial, and risk  
13 management. Consistent with its strategic plan for the past several years, BCBSMT has  
14 been evaluating outsourcing options. In short, without the alliance, BCBSMT will need  
15 to further outsource its functions and become dependent on other entities for its  
16 technology and other administrative needs.

17 **Q. ARE THERE ANY OTHER POTENTIAL ADVERSE IMPACTS TO THE STATE**  
18 **OF MONTANA IF THIS ALLIANCE IS NOT APPROVED?**

19 **A.** Yes, there are several. First, if the alliance is not approved, the foundation which would  
20 hold the remaining assets of the old BCBSMT corporate entity will not be established at  
21 this time, thereby depriving the State of Montana and its citizens of approximately  
22 \$120M. This is not in the public's best interest. It is also pertinent that the amount of

1 money to be deposited in the foundation will never likely be greater than it will be in the  
2 next six (6) months. This is due to the amount of investment BCBSMT would be  
3 required to make in the next 18 months in technology or outsourcing. In addition, as  
4 BCBSMT struggles with its costs and expenses in a post-ACA environment, if and when  
5 BCBSM does associate with another alliance partner, it will likely leave less in assets, not  
6 more, for a foundation. Second, if BCBSMT remains a standalone entity, as already  
7 mentioned, it will be forced to outsource many of its services to meet the coming  
8 challenges of the health reform market. Outsourcing will likely result in the elimination  
9 of BCBSMT jobs. In contrast, while outsourcing of services to HCSC will occur with the  
10 alliance, HCSC will take BCBSMT's current employees because HCSC's present  
11 membership of 13.5 million policyholders supports absorption of BCBSMT's workforce.  
12 In this electronic age, employees can provide services to the HCSC enterprise no matter  
13 where they are located. Montana employees can support technology and systems located  
14 in multiple states, i.e., Illinois, Texas, New Mexico, and Oklahoma. Likewise, Montana  
15 employees can provide customer services to policyholders located anywhere. However,  
16 the HCSC full service unit in Great Falls, which represents approximately 100 new jobs,  
17 has no possibility of occurring if the alliance does not happen.

18 **Q. DO YOU BELIEVE THAT THIS TRANSACTION HAS THE LIKELIHOOD OF**  
19 **CREATING A SIGNIFICANT ADVERSE EFFECT ON THE AVAILABILITY**  
20 **OR ACCESSIBILITY OF HEALTHCARE SERVICES OR HEALTH**  
21 **INSURANCE COVERAGE IN MONTANA?**

1    **A.**    No, quite the opposite. As I previously testified, I believe the transaction will increase  
2           Montanans' access to health insurance coverage and healthcare services.

3    **Q.**    **DO YOU BELIEVE THAT THIS TRANSACTION INCLUDES SIGNIFICANT**  
4           **SAFEGUARDS TO ENSURE THAT MONTANANS WILL HAVE CONTINUED**  
5           **ACCESS TO AFFORDABLE HEALTHCARE?**

6    **A.**    Yes, I do. As I previously testified, the economies of scale and related enhancements and  
7           capital inflow this transaction will deliver for BCBSMT members and other stakeholders  
8           are necessary to preserve a viable and price competitive Blue plan alternative in Montana.

9    **Q.**    **DID BCBSMT HIRE AN EXPERT TO ASSIST IT WITH NEGOTIATING THIS**  
10          **TRANSACTION?**

11   **A.**    Yes. BCBSMT felt it was important to have a professional legal advisor who specialized  
12          in this type of transaction and was an experienced negotiator to assist and advise the  
13          Board and senior management and to work on their behalf. We hired the law firm of  
14          Graham & Dunn PC ("Graham & Dunn"), to represent and assist BCBSMT in  
15          negotiations of the APA with HCSC, to advise on due diligence issues, and other  
16          associated issues. Graham & Dunn employs attorneys whose experience covers a broad  
17          range of corporate law and corporate transactions matters, with a focus on mergers and  
18          acquisitions and complex negotiations. Graham & Dunn also advised BCBSMT on  
19          antitrust issues and provided legal advice to the Board and senior management on the  
20          structure of the transaction and other transaction issues.

21   **Q.**    **WAS BCBSMT REQUIRED TO MAKE ANY OTHER FILINGS WITH ANY**  
22          **OTHER GOVERNMENT ENTITY?**

1    **A.**     Yes. BCBSMT and HCSC also filed a Hart-Scott-Rodino filing with the Department of  
2           Justice (DOJ) and the Federal Trade Commission (FTC) as required by federal law.

3    **Q.**     **WHAT IS THE STATUS OF THE FILING?**

4    **A.**     BCBSMT received the letter issued on February 5, 2013, by the FTC and DOJ granting  
5           the parties' request for early termination of the waiting period, indicating that there were  
6           no antitrust concerns identified by either the FTC or the DOJ with respect to the proposed  
7           alliance.

8    **Q.**     **THE MONTANA CONVERSION STATUTE DISCUSSES THE PROTECTION**  
9           **OF THE PUBLIC ASSETS. FOR PURPOSES OF THIS TRANSACTION ONLY,**  
10          **WHAT ARE THE PUBLIC ASSETS?**

11   **A.**     For purposes of this alliance and transaction only, and for no other purpose, BCBSMT  
12           and HCSC stipulated that the Conversion Statute applies as though BCBSMT is a  
13           Montana public benefit corporation. It is my understanding that the following assets are  
14           public assets as defined in Montana Code Annotated § 50-4-701(9): (1) the assets and  
15           liabilities of the Acquired Business; and (2) the assets that remain in the old BCBSMT  
16           entity, but only after old BCBSMT has satisfied or otherwise discharged the remaining  
17           liabilities of old BCBSMT, including those of its subsidiaries.

18   **Q.**     **HOW WILL THE PUBLIC ASSETS BE DISTRIBUTED IF THE ALLIANCE IS**  
19          **APPROVED?**

20   **A.**     On December 19, 2012, the Hearing Examiner issued a Prehearing Schedule and  
21           Procedural Order in which the Public Hearing was bifurcated into two phases. The first  
22           phase, taking place on February 12 and March 12, 2013, will examine whether the



1 alliance is in the public interest and should be approved. If the alliance is approved, the  
2 second phase of this public hearing will deal with how the public assets will be  
3 distributed.

4 **Q. WILL ANY PART OF BCBSMT'S PUBLIC ASSETS INURE DIRECTLY OR**  
5 **INDIRECTLY TO AN OFFICER, DIRECTOR, OR TRUSTEE OF BCBSMT OR**  
6 **OF HCSC OR TO ANY OTHER PERSON THAT IS NOT A FOUNDATION OR**  
7 **NONPROFIT ORGANIZATION APPROVED TO RECEIVE THE ASSETS BY**  
8 **THE ATTORNEY GENERAL?**

9 **A.** No.

10 **Q. WILL ANY OFFICER, DIRECTOR, OR TRUSTEE OF BCBSMT RECEIVE**  
11 **ANY IMMEDIATE OR FUTURE REMUNERATION AS A RESULT OF THE**  
12 **PROPOSED CONVERSION TRANSACTION EXCEPT FOR THE**  
13 **REASONABLE VALUE OF SERVICES RENDERED PURSUANT TO A VALID**  
14 **CONTRACT BETWEEN THE OFFICER, DIRECTOR, OR TRUSTEE AND**  
15 **BCBSMT?**

16 **A.** No.

17 **Q: ARE YOU AWARE OF ANY CONFLICTS OF INTEREST THAT BCBSMT**  
18 **BOARD MEMBERS HAVE OR WOULD HAVE WITH RESPECT TO THE**  
19 **PROPOSED TRANSACTION?**

20 **A.** No.

21 **Q. ARE YOU AWARE OF ANY CONFLICTS OF INTEREST THAT BCBSMT**  
22 **MANAGEMENT OR EXECUTIVES HAVE OR WOULD HAVE WITH**

1           **RESPECT TO THE PROPOSED TRANSACTION?**

2   **A.**    No.

3   **Q.**    **ARE YOU AWARE OF ANY CONFLICTS OF INTEREST THAT ANY**  
4           **EXPERTS RETAINED BY BCBSMT OR HCSC HAVE WITH RESPECT TO THE**  
5           **PROPOSED TRANSACTION?**

6   **A.**    No.

7   **Q.**    **HAVE ANY OF THE EXPERTS RETAINED BY BCBSMT OR HCSC WITH**  
8           **RESPECT TO THIS TRANSACTION RENDERED SERVICES FOR OR ON**  
9           **BEHALF OF BCBSMT PRIOR TO THEIR ENGAGEMENTS IN CONNECTION**  
10          **WITH THE PROPOSED TRANSACTION?**

11   **A.**    No.

12   **Q.**    **ARE THERE ANY MANAGEMENT CONTRACTS BEING TRANSFERRED TO**  
13          **HCSC BY BCBSMT?**

14   **A.**    No.

15   **Q.**    **HAVE YOU BEEN PROMISED ANY BENEFIT IN YOUR CURRENT ROLE**  
16          **UPON COMPLETION OF THE ALLIANCE OR ANY TYPE OF AGREEMENT**  
17          **OR CONTRACT WITH HCSC AS A RESULT OF THIS TRANSACTION?**

18   **A.**    No. I have not entered into any type of agreement or contract with HCSC, and HCSC has  
19          not promised me anything other than employment commensurate with my current role  
20          with BCBSMT within the HCSC structure.

21   **Q.**    **DOES THIS CONCLUDE YOUR TESTIMONY?**

22   **A.**    Yes.

Respectfully submitted this 5<sup>th</sup> day of March, 2013.

KELLER, REYNOLDS, DRAKE,  
JOHNSON & GILLESPIE, P.C.

BY: Jacqueline T. Lenmark  
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### CERTIFICATE OF SERVICE

I, Jacqueline T. Lenmark, KELLER, REYNOLDS, DRAKE, JOHNSON & GILLESPIE, P.C., certify that on March 5, 2013, I served a true and correct copy of the foregoing Direct Testimony of Michael E. Frank, by mailing it first class postage prepaid to:

Ms. Sybil Shults  
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Securities & Insurance  
State Auditor's Office  
840 Helena Avenue  
Helena, MT 59601

Honorable W. William Leaphart  
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Helena, MT 59601

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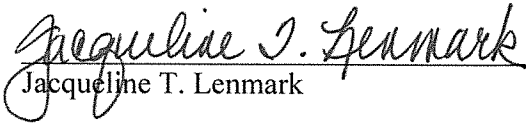
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*Pro hac vice for CSI*

DATED this 5<sup>th</sup> day of March, 2013.

  
Jacqueline T. Lenmark

## VERIFICATION

STATE OF MONTANA )  
 )  
 ) ss.  
COUNTY OF LEWIS AND CLARK )

I, MICHAEL E. FRANK, being first duly sworn, upon my oath, state that I have read, know and understand the contents of the foregoing testimony and that the statements contained therein are true and correct to the best of my knowledge, information and belief.

Michael E. Frank  
MICHAEL E. FRANK

SUBSCRIBED, SWORN TO AND ACKNOWLEDGED before me this 5 day of  
March, 2013, by MICHAEL E. FRANK.

Notary Public

My Commission Expires:

10/21/2016

